



**Submission to**

**The Select Committee  
of  
The Legislative Assembly of Ontario**

**on the**

**Proposed Transaction of the TMX Group and London Stock  
Exchange Group**

**March 9, 2011**

The Investment Industry Association of Canada is pleased to have the opportunity to appear before the Select Committee of the Legislative Assembly of Ontario on the proposed transaction of the TMX Group and the London Stock Exchange Group. These two exchange groups announced on February 5, 2011 an intention to merge their trading, listing and clearing businesses. Both of these exchange groups provide important marketplaces for transacting in equities, derivatives, and commodities, and facilitate capital-raising for investors and issuers throughout the world. The merger of these two financial institutions will have a significant impact on global financing and trading activity, and on capital formation and economic growth.

The Association represents 200 investment dealer registrants that account for the majority of financial advisory work, trading and underwriting in public and private equity markets. Investment dealers – designated Participating Organizations – carry out trading and underwriting activity on the Toronto Stock Exchange and TSX Venture Exchange. Through discussions with individual IIAC member firms and Association industry committees, the Association has identified some key issues and concerns in respect of the proposed merger that need clarification and possibly remedy.

The Association hopes these comments will help the Select Committee better understand the transaction, its impact on the Ontario financial community and at large, and how the transaction will influence the longer term outlook for the Ontario financial services sector and economy.

### **Global Consolidation of Exchanges**

Over the past few months, we have witnessed successive proposed consolidations of leading exchange groups around the world. These merger transactions include the ASX-SGX merger, the TMX-LSE merger and the Deutsche Börse-NYX merger. In addition, two alternative trading systems, BATS and Chi-X Europe, have agreed to consolidate operations. The transaction, however, is much smaller in size (about \$300 million) than the three aforementioned exchange mergers, arguably regional in nature and, importantly

would combine entities that are not incumbent or listings markets today. Member firms of the Investment Industry Association of Canada understand the rationale behind these mergers and in principle support this global integration and consolidation of markets. These trans-national exchange mergers should over time improve access to, and reduce the cost of, equity capital for listed companies. However, the main benefit will be technology platform consolidation that should offer the opportunity to lower transactions costs for investors, assuming the shareholders of the combined exchange group themselves share some of these savings with the users. Lower transaction costs are not only a benefit to secondary market participants such as dealers and asset managers, but should make the secondary market more liquid and efficient, which lowers the cost of capital and enhances primary market capital formation.

These mergers have been orchestrated by the exchanges (themselves recently demutualized) and profit-motivated, that have been influenced by growing trading and listing opportunities in the global marketplace and challenged by the commoditization of trading, stiff competition from electronic trading platforms and proliferation of derivative products for trading and clearing. Mergers also provide the opportunity for scale (expanding trading volumes and lowering trading costs through the consolidation of technology platforms, as well as potentially improving technology to compete more effectively with alternative electronic trading platforms), the ability to offer a wider range of products that are less subject to competition, such as proprietary indexes and non-fungible derivatives, and exposure to faster growing asset classes and/or listings markets. The pace of mergers is arguably quickening as candidates seeking a merger opportunity have sought out attractive partners before they fall into the hands of others.

### **The TMX Group-LSE Group Merger**

The TMX Group-LSE Group merger was billed as a merger of equals. The TMX Group will appoint seven of the 15 directors to the merged Board of Directors, just short of a majority reflecting the proposed 45-55% ownership share of the TMX Group and LSE Group respectively. The merger contemplates two separate and distinct traded equity markets for each jurisdiction in Canada and the United Kingdom. At the outset, the stock

exchanges will promote inter-listings and seek to attract new listings, share expertise to build out derivatives and bond trading, and cross-sell data products and delivery solutions (such as co-location) on each respective market, as well as share specific products and services. Within a short timeframe, the merged exchange group will likely move to integrate technology, particularly for trading cash and derivative securities, and possibly for clearing and settlement, to gain a competitive edge in global trading and clearing, and achieve cost synergies.

The merger raises several key questions from market participants, other stakeholders and regulators. First, will the merged entity provide deeper financing and trading opportunities through inter-listing for TSX and TSX Venture-listed companies to improve share liquidity and access to capital or will there be significant costs for interlisting and cross-registration? Second, will the merged exchange result in an erosion of trading and financing activity from either interlisting or changes in primary listing designation by Canadian companies? Third, will the merged stock exchange group result in lower or higher costs for market participants, including listed Canadian companies and dealers, in carrying out normal business? Fourth, will the contemplated integration of trading and clearing technology, particularly the integration of trading platforms, lead to higher costs for market participants, trading delays and possible market dislocations? Fifth, will technology expertise and IT development work consolidate in a central location outside of Canada? And sixth, what outcomes might arise should the merged stock exchange group experience a market downturn or not achieve expected synergies?

### **Interlisting Opportunities**

The stock exchange merger is intended to benefit large and small Canadian companies listed on the TSX's two markets by offering improved opportunities for interlisting and trading on both major stock exchanges in Toronto and London. This would in theory improve share liquidity and cost of capital for TSX listed companies. Will the benefits of interlisting, however, be realized easily by TSX listed companies, or will there be significant costs for additional listing fees and registration costs from cross-listing? Listing fees are higher at the LSE than the TSX. Can the LSE Group provide assurance

that listing fees for interlisting TSX companies will be reasonable and modestly incremental to primary listing fees? Further, TSX listed companies interlisting on the LSE will be subject to distinct U.K. regulatory listing standards, raising compliance costs to meet these requirements. As a result of these higher costs, it is likely that interlisting activity will be minimal, at least in the short run. In reality, there have been few cross-listings between the Euronext exchanges and the NYSE since the merger of their parent companies was completed in 2007, reflecting differences in regulatory standards. In the nearly four years since the Euronext-NYSE merger, only 10 additional companies interlisted, resulting in a total of 60 interlisted firms, out of a total of 4,500 combined listings on the merged stock exchange.

The big benefit from interlistings could come from attracting non-Canadian issuers who may see the combined Canadian-U.K. liquidity pool as a potentially more compelling listings value proposition than if either market is viewed independently, reflecting the opportunity to cross-list. This appeal, however, will depend importantly on harmonizing regulatory regimes and ensuring that incremental listings costs are not prohibitive. In light of this outcome, does the merged TMX/LSE group anticipate making headway over time in pushing for greater harmonization of listing standards between the Canadian securities regulators and the U.K. Financial Services Authority (FSA)?

If cross-listing is an expensive proposition for many TSX listed companies, will these companies, especially those in the energy and mining sector with a majority of assets held outside Canada (roughly 75% of the total number of mining companies), have an incentive to shift to a primary listing in London? The decision would appear to be a trade-off between the attraction of the global profile and the larger liquidity pool in the London market versus the stronger interest from domestic investors in Canadian companies and the recognition and high reputation of a TSX listing in these specific sectors. Further, does regulatory arbitrage provide an incentive to shift to a primary listing to London?

If Canadian companies decide to interlist on the London market, Canadian dealers with relationships with these companies will be required to register on the LSE to provide trading and financing support in both marketplaces. The large Canadian dealers are already registered and members of the LSE. However, many small Canadian dealers are not, and LSE registration costs, coupled with the necessary logistics for trading in London market hours, would be significant. It is clear that significant cost efficiencies could be achieved through regulatory harmonization and recognition. Are there plans to petition the Canadian securities regulators and the FSA to move quickly with regulatory recognition in key areas such as listing requirements? An expedited review by Canadian and U.K. regulators of the merits of mutual recognition of listing requirements should be an important first step, with concrete action to follow to yield the benefits of cross-listing.

### **TSX Venture Market**

The TSX Venture market is recognized as a liquid, efficient and well-regulated equity marketplace for small and mid-sized companies. The TSX Venture market has been effective in bringing small private companies to public markets, delivering market exposure and capital-raising opportunities, and helping these companies expand operations and build revenues and earnings in making the transition to mid-sized and larger firms. The TSX Venture market is an effective stepping-stone or incubator for small companies destined for the TSX.

The AIM market is the analogous small business marketplace of the London Stock Exchange Group. In contrast to the success of the TSX Venture Exchange, the AIM market has struggled in recent years, handicapped by its framework of light regulation resulting in several well-publicized business controversies. How specifically can the AIM market assist small, private Canadian companies or small companies already listed on the TSX Venture Exchange? Would the proposed merger of the TMX and LSE deliver trading technology or other services to improve the functioning of the TSX Venture Exchange?

### **Needed Pricing Restrictions on Equity Market Data**

The dominance of the TMX Group and London Stock Exchange Group in their respective markets, and the demand inelasticity for real-time pre-trade and post-trade share price information to meet regulatory best price obligations for clients, has given these exchanges market power to raise data prices and generate substantial revenues from market data. Market data revenues for the TSX Group and LSE Group respectively account for 25% and 18% of total exchange revenues, a relatively high proportion of revenues.

If revenue synergies anticipated from the merger transaction fail to materialize and operating costs of the merged entity exceed expectations, will the merged stock exchange group fill the revenue shortfall through further increases in the prices for market data? The IIAC has recommended Canadian securities regulators impose on stock exchanges and alternative trading systems (ATs) pricing restrictions for market data to protect investors from unfair pricing practices. These regulatory pricing requirements become even more important in the context of the proposed stock exchange merger.

### **Integration of Technology**

In the early stages of the exchange merger, the combined groups will each operate independent stock exchanges, with the initial focus on expanding revenue through new listings, interlistings, the distribution of branded products (such as the FTSE and S&P indices), and identifying synergies to reduce operating costs. Over time, the key strategic focus to strengthen competitive position will be integrating the best existing technology for trading in cash and derivative securities, and for the clearing and settlement of these securities. Leading-edge technology at both organizations (*Millennium IT* and SOLA for cash and derivatives trading, respectively) was a motivating factor behind the merger. Technology development will be a key business focus.

The LSE Group recently introduced its new trading technology, *Millennium IT*, first into its alternative trading platform, Turquoise, and more recently into the LSE. It is likely this technology will replace the TSX *Quantum* technology. History has demonstrated the

introduction of new trading technology in marketplaces results in significant costs to market participants, delays in implementation and potential market disruptions. Canadian participants have just gone through a costly linkage with the TSX *Quantum* technology and will now be expected to pay for interconnectivity to a new system. Will the *Millennium IT* technology be implemented at the TSX? What is the timing of implementation and estimated costs of this technology for the dealer community and other market participants? What are the risks of market disruption, especially in light of the repeated disruptions LSE Group has experienced in both its Turquoise and LSE markets after deploying Millennium? The shutdown of trading on the LSE on February 25 was the third trading glitch in four months.

While the LSE has announced that TMX's derivatives trading technology will be utilized in developing the Turquoise derivatives pan-European business, is there a long-term commitment to this strategy given the desires for scale and Millennium's experience with developing other derivatives platforms, as well as its lower-development-cost base at its Colombo, Sri Lanka headquarters? Does the potential instability in Sri Lanka, even with an end to the civil war, pose further risk, even if just equity platform development is based there? Does the merged group have plans to overhaul clearing and settlement technology in the cash and derivatives markets in Canada utilizing the clearing and settlement assets LSE acquired in its 2007 takeover of Borsa Italiana? Would the TSX Group take advantage of the Borsa Italiana's clearing and settlement platform technology to compete with the Canadian Depository for Securities Ltd. (CDS), the dealer- and bank-owned utility in Canada, potentially adding operational costs for the Canadian dealers? Are there plans to consolidate technology expertise and ongoing development work and, if so, where will it or the various functions be located – Toronto, Montreal, London, Milan or Sri Lanka? Similar to previous deals such as the TSX-Montreal Bourse, the NYSE-Euronext deal in 2007, and the pending ASX-SGX deal, commitments to local investment, local operations, and staff should be considered (see attachment), in addition to the maintenance of Canadian regulatory oversight of the Canadian markets, which will certainly be a condition to the deal.

## **Changes to Organizational Structure**

The proposed organizational structure of the merged exchange is a de-centralized model that reflects the legacy of previous acquisitions by both stock exchange groups. The London Stock Exchange Group operations are divided between London and Milan-Rome, with a technology hub in Sri Lanka. The TMX Group will operate through four Canadian centres in Toronto, Montreal, Calgary and Vancouver. Calgary will become the global listing centre for energy, as well as joint headquarters for the TSX Venture Exchange, while Montreal becomes the global derivatives centre for the merged group. Will any failure to meet revenue and cost projections – whether because commodities and derivatives markets become less active, merger synergies do not materialize as expected, or otherwise – force structural adjustments on the organization? How would the rationalization of operations unfold in the merged exchange group? What would be the decision-making mechanism for management and the Board of Directors? It should be noted, as a point of reference, given the perceived difficulty the Australians are having in getting the SGX-ASX deal approved, the exchanges have now made concessions to have equal representation from Singaporean and Australian citizens, plus three international directors, on the Board.

Is there a sunset on the seven TSX-appointed directors out of the total 15 Board members? In the Deutsche Börse-NYSE merger, Deutsche Börse's rights to majority board representation expire within a few years, raising the possibility that the acquired company will wind up controlling the merged entity over the long term. Could this work the other way round in the TMX Group-LSE Group merger, with the LSE controlling more of the board over time unless protections are in place? What are the protections for the TMX Group, in terms of Board and management representation, if further mergers or acquisitions are undertaken?

## **Conclusion**

It is inevitable that Canada, with its successful stock exchange and high profile in global capital markets, would be caught up in the trend towards global consolidation of stock exchanges. It is inappropriate to judge this particular merger against hypothetical

alternatives. This is the merger that has been negotiated and agreed by two corporate boards, and is the merger on the table. The responsibility of governments and regulators is to judge this particular merger on its merits in terms of the impact on Canadian markets, market participants and the economy. The merger candidates should be open to suggestions to clarify and address aspects of the transaction raised as legitimate concerns.

Some of the Association's key observations and comments are as follows:

1. The evidence from the previous trans-Atlantic merger of Euronext and NYSE, and likely absence of regulatory harmonization between the FSA and Canadian regulators in the near term, suggests cross-listings of TSX listed companies will be minimal. The large Canadian companies are already interlisted on the NYSE and Nasdaq, and will continue with these interlistings, given the substantial pools of liquidity they represent already. An expedited review by Canadian and U.K. regulators of the merits of mutual recognition of listing requirements should be an important first step, with concrete action to follow to yield the benefits of cross-listing.
2. There appears to be some risk of shift in primary listings to London from the TSX, particularly for mid-sized Canadian companies with most of their assets held outside Canada. A change in primary listing by a significant number of Canadian companies would shift trading and financing activity to the London market to the detriment of the Canadian dealer community and Toronto financial infrastructure. More analysis is needed to understand whether a shift in primary listings would be significant and its impact on the clusters of expertise and jobs here.
3. The merged exchange group may resort to greater reliance on market data revenue by charging higher prices, particularly if revenue and cost synergies from the merger fail to materialize. Both stock exchanges now rely heavily on high-margin market data for earnings performance. Canadian regulators should

become more pro-active in introducing regulatory restrictions on market data pricing, similar to SEC regulations in the United States.

4. There will likely be an accelerated move to integrate “best in class” technology for cash and derivatives trading on the exchanges in the merged group. It is unclear what the magnitude and timing of these changes will be and the impact of the costs on market participants. Further, the risks of delay in implementing technology change and possible market dislocation are a concern. The TSX Group and LSE Group should provide a detailed assessment of the timing and likely impact of proposed technology changes for the cash and derivatives markets.
5. Technological advances are key to the competitive success of the merged exchange group. The combined exchanges will focus considerable resources on technology integration and the development of new trading and clearing technology. It is unclear whether the Group will establish a key centre or centres for technology expertise and where it/they would be located. Clarifications from the exchanges would benefit those examining the transaction.
6. The decentralized structure of the merged stock exchange group may give way to rationalization in the event of a market downturn or if merger synergies fail to materialize. We would appreciate understanding what the contingency plan for the possible rationalization of organizational structure and the decision-making mechanism might look like.

# MARKET ANNOUNCEMENT

## JOINT NEWS RELEASE

15 February 2011

### New ASX-SGX governance arrangements and commitments to strengthen the merger proposal

- **Equal number of Australian and Singaporean directors**
- **Commitments to maintain operations, assets and key staff in Australia**
- **Commitments to invest in, develop and introduce new products and services in Australia and Singapore**

ASX Limited (ASX) and Singapore Exchange Limited (SGX) have agreed to make changes to the governance arrangements of, and provide further commitments in connection with, their merger proposal, which will strengthen the development of the financial services sectors and the national interests of both Australia and Singapore.

This follows engagement by both parties with a wide range of stakeholders since the merger proposal was announced on 25 October 2010.

**David Gonski AC, Chairman of ASX**, said: “Recent developments in global exchange mergers affirm the judgement of the ASX Board that ASX must participate in regional and global consolidation. “The changes and commitments announced today, combined with existing regulatory protections, strengthen our belief that the ASX-SGX merger proposal is in the best interests of shareholders and in the national interest of Australia.”

**Chew Choon Seng, Chairman of SGX**, said: “These commitments demonstrate SGX’s belief in the merits and benefits of the merger, address concerns that have been expressed, and provide further clarity as to how the merged entity will operate in the future to create growth and deliver value for shareholders and all stakeholders.”

Key changes and commitments include:

#### **Governance**

1. There will be five Australian and five Singaporean citizens appointed to a 13 member Board of ASX-SGX Limited (ASX-SGX), reduced by two from the original announcement, and the Board would include three international directors and these arrangements would last for five years.
2. ASX and all of its licensed subsidiaries, as well as ASX Compliance, will maintain Boards with a majority of Australian citizen directors and an Australian citizen as Chair.
3. Chew Choon Seng, current Chairman of SGX, will be Chairman of the combined group. David Gonski, current Chairman of ASX, will be the combined group’s Deputy Chairman, as well as Chair of the ASX-SGX

Integration Committee that will oversee a successful integration, with a focus on building centres of excellence in both Australia and Singapore.

4. ASX-SGX Limited will maintain a listing on both ASX and SGX exchanges, as previously announced.

### ***Existing Australian operations***

5. All physical assets required for the operation of ASX Group businesses, including listing, trade execution, clearing and settlement, and all dedicated data and data recovery centres will continue to be developed and located in Australia, and owned and operated by Australian incorporated entities.
6. Senior management will continue to be based in Australia, accessible to customers and other stakeholders locally.
7. Companies and products listed and quoted on ASX exchanges will continue to be listed and quoted on these exchanges.
8. Clearing and settlement of trades conducted on any ASX operated licensed Australian market will occur in Australia.

### ***Fees and capital investment in Australia***

9. Fee structures in Australia will be responsive to the Australian commercial environment and will continue to be competitive. These fees will be set independently of, and without reference to, the fees charged by ASXSGX Group for products and services in Singapore or any other jurisdiction in which the Group may operate.
10. To create and deliver growth in Australia, capital expenditure in Australia will be at least 5% of Australian operating revenue (excluding interest income) per annum with a minimum expenditure of A\$30 million in the first five years, in keeping with investment levels of recent years.

### ***Future developments***

11. ASX will continue to meet the needs of the Australian market for a comprehensive range of listing, trade execution, clearing, settlement and market information products and services for Australia's primary, secondary and derivative markets.
12. ASX-SGX will work closely with regulators in both jurisdictions and, subject to regulatory approval, introduce a range of initiatives as soon as possible, leveraging the strengths of both ASX and SGX, including:
  - o An Australian dollar interest rate swaps clearing facility for over-the-counter financial products to strengthen links with global OTC markets and reduce systemic risks and costs to market users;

- o A passport listings service, initially available for the top 200 stocks, this will enable streamlined admission arrangements for SGX issuers to join ASX (and vice versa) to expand their Australian and Asian investor base and improve their access to capital;
  - o Mutual offset arrangements to enable holders of ASX and SGX derivatives positions to consolidate their exposures and reduce their costs;
  - o Cross product listing and cross access arrangements to enable ASX and SGX participants to gain access to the full suite of products offered by the ASX-SGX Group to improve distribution, liquidity and widen the breadth of product offering for ASX participants; and
  - o Wholesale and retail fixed income platforms to enable companies to improve access to, and reduce the cost of, debt capital and to provide alternative debt investment instruments for investors on a transparent contemporary platform.
13. ASX-SGX Group is committed, consistent with regulatory requirements, to invest in Australia in the:
    - o Number of companies admitted to the official list of Australian licensed financial markets in the ASX Group;
    - o Breadth of products and services quoted on ASX; and
    - o Network of ASX participants facilitating access to ASX Group markets.
  14. Centres of excellence will be based both in Australia and Singapore to drive product innovation, leverage relationships with intermediaries and liquidity providers, and to develop new international products and services that will be distributed to the Asia-Pacific marketplace.
  15. Expansion will continue of the interest rate, equity, energy and environmental derivative product suite to meet the needs of market users for a wide range of trading and risk management instruments, with expertise and resources leveraged from both ASX and SGX.

***No change to existing protections of Australia's national interest***

16. Existing Australian regulatory oversight by Australian regulatory bodies, as well as Australian approval requirements for changes in the ownership of ASX-SGX, will continue following the merger of ASX and SGX.
17. The Australian operations will continue to be licensed under the Corporations Act and remain subject to oversight and annual assessment by the Australian Securities and Investments Commission (ASIC) and the Reserve Bank of Australia (RBA).
18. Changes to all ASX Operating Rules, including Listing Rules, will continue to be scrutinised by ASIC and be subject to Ministerial disallowance before becoming effective.

19. Changes to the capital structure of ASX clearing houses will continue to be regulated by the RBA.
20. Any proposed acquisition of a merged ASX-SGX will require approval under Australian law, including the approval processes of the Foreign Investment Review Board (FIRB), Treasurer and Corporations Act.
21. The ASX Corporate Governance Council will be maintained. The Chair of the Council will conduct a review as to how to work with regional counterparties to develop and harmonise corporate governance practices across the region.